

Message Text

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LIMDIS- GREENBACK

DEPARTMENT PASS TREASURY AND FEDERAL RESERVE

E. O. 11652: GDS

TAGS: EFIN, GW

SUBJECT: GERMAN MONETARY POLICY

REF: BONN 6816

1. SUMMARY: DURING A RECENT VISIT TO FRANKFURT THE FINANCIAL ATTACHE FOUND BUNDESBANK BOARD MEMBERS GENERALLY RELAXED REGARDING INTERNATIONAL MONETARY DEVELOPMENTS, DETERMINED TO CONTINUE VERY TIGHT DOMESTIC MONETARY POLICIES AND MODERATELY OPTIMISTIC THAT INFLATIONARY TRENDS IN GERMANY COULD BE REVERSED BY THE SPRING OF 1974 WITH FIRST INDICATIONS POSSIBLY BECOMING VISIBLE IN THE FALL. PRIVATE BANKERS AND FOREIGN EXCHANGE DEALERS FELT THAT ANOTHER SMALL REVALUATION OF THE DM IN THE FALL REMAINED A DISTINCT POSSIBILITY. WHILE ALMOST EVERYONE AGREED THAT IN THE MEDIUM TO LONGER RUN THE DOLLAR IS NOW UNDERVALUED, MOST PRIVATE BANKERS FELT THAT IN THE SHORT RUN IT PROBABLY WOULD SINK LOWER BEFORE IT BEGAN TO RECOVER. THERE WAS A VERY STRONG CONSENSUS AMONG BOTH PRIVATE BANKERS AND BUNDESBANK OFFICIALS THAT IT WOULD BE A MISTAKE TO INTERVENE AT THIS TIME IN SUPPORT OF THE DOLLAR IN THE FOREIGN EXCHANGE MARKETS. END SUMMARY

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2. BUNDESBANK BOARD MEMBERS WERE SURPRISED AT THE DEGREE OF EASING IN THE GERMAN MONEY MARKETS AND SOMEWHAT WORRIED AND NOT ENTIRELY CLEAR WHY THEIR DOMESTIC INSTRUMENTS OF MONETARY CONTROL WERE NOT QUITE AS EFFECTIVE AS THEY HAD EXPECTED. MINIMUM RESERVES, FOR EXAMPLE, WERE NOT RISING AS MUCH AS THEY SHOULD. ALL BOARD MEMBERS WITH WHOM THE FINANCIAL ATTACHE SPOKE WERE DETERMINED TO KEEP MONETARY POLICY VERY TIGHT AND NUANCES OF DISAGREEMENT INVOLVED ONLY IF MONETARY POLICY SHOULD HAVE BEEN TIGHTENED EVEN MORE DURING THE LAST FEW WEEKS. FOR THE IMMEDIATE FUTURE, BOARD MEMBERS SEEMED TO BE THINKING IN TERMS OF STERILIZING MORE MONEY THROUGH A NEW TRANCH OF THE STABILITY LOAN AND THE SWITCH OF SOME DEPOSITS OF THE SOCIAL INSURANCE SYSTEM FROM THE COMMERCIAL BANKS TO THE CENTRAL BANK SYSTEM RATHER THAN IN TERMS OF FURTHER INCREASES IN THE REDISCOUNT RATE.

3. NO ONE AT THE BUNDESBANK EXPRESSED ANY WORRY ABOUT THE EXTERNAL ASPECTS OF GERMAN TIGHT MONEY POLICIES OR FEAR OF STRAINS IN THE EC SNAKE. EMMINGER TOLD THE FINANCIAL ATTACHE THAT IN EXCHANGING VIEWS AT BASLE THIS WEEK, THE GOVERNORS OF ALL OF THE CENTRAL BANKS FROM THE EC SNAKE COUNTRIES REPORTED THAT THE FURTHER APPRECIATION OF THEIR CURRENCIES AGAINST THE DOLLAR WAS AT PRESENT CAUSING NO SIGNIFICANT DIFFICULTIES FOR THEIR EXPORT INDUSTRIES OR LEADING TO ANY PRESSURE ON THE CENTRAL BANKS FROM EXPORT INTERESTS. ON THE CONTRARY PRACTICALLY ALL EUROPEAN EXPORT INDUSTRIES WERE CONTINUING TO BOOM BECAUSE OF THE VERY HIGH LEVEL OF INTERNATIONAL AND PARTICULARLY OF US DEMAND. EMMINGER, THEREFORE, FORESAW NO GREAT DIFFICULTY WITH GERMANY'S SNAKE PARTNERS IN THE NEAR TERM IF THE DM SHOULD PULL THE SNAKE UP FURTHER VIS A VIS THE DOLLAR.

4. BUNDESBANK OFFICIALS FELT THAT TIGHT MONETARY POLICIES AND THE GOVERNMENT'S STABILITY PROGRAM WERE ALREADY HAVING SOME FIRST EFFECTS IN A FEW SECTORS OF THE ECONOMY (FOR EXAMPLE BUILDING). THEY HOPED THAT THE GOVERNMENT'S EFFORTS WITH THE LABOR UNIONS AND A DECREASE IN FOOD PRICES IN THE FALL MIGHT SUCCEED IN MODERATING

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UPCOMING WAGE DEMANDS. THEY EXPECTED THAT BY THE TURN OF THE YEAR THE TIGHT MONETARY POLICIES WOULD HAVE THEIR FULL BRAKING EFFECT ON THE ECONOMY.

5. ALMOST EVERYONE IN FRANKFURT CONSIDERED THE DOLLAR NOW IRRATIONALLY UNDERVALUED, BUT MOST PRIVATE BANKERS AND FOREIGN EXCHANGE DEALERS FELT IT MIGHT WELL SINK

INTO THE \$1.00 EQUALS DM 2.40-2.50 RANGE BEFORE IT
WOULD BEGIN TO RECOVER. THE VERY KNOWLEDGEABLE EXCHANGE
DEALER OF ONE OF THE LARGEST BANKS WAS THE ONE EXCEPTION.
HE INDICATED THAT AMONG HIS CLIENTS THERE WAS A VERY
DISTINCT TENDENCY TO UNWIND PREVIOUS HEDGE POSITIONS
(AND THUS FURNISH SUPPORT TO THE DOLLAR) WHENEVER THE
\$/ DM RATE CAME INTO THE DM 2.55-2.57 RANGE AND HE FELT
THIS WOULD BE VERY CLOSE TO THE BOTTOM.

6. BUNDESBANK AS WELL AS COMMERCIAL BANK OFFICIALS
WERE UNANIMOUSLY OF THE OPINION THAT IT WOULD BE A
MAJOR MISTAKE TO SUPPORT THE DOLLAR THROUGH CENTRAL BANK
INTERVENTION AT THIS TIME ON EITHER SIDE OF THE ATLANTIC.
SUCH INTERVENTION WOULD LEAD TO A TESTING OF THESE
INTERVENTION POINTS AND DISASTER IF THEY WOULD HAVE TO
BE ABANDONED UNDER PRESSURE.

7. MOST PRIVATE BANKERS CONTINUED TO BELIEVE THAT THERE
WAS A EVEN CHANCE FOR ANOTHER SMALL DM REVALUATION THIS
FALL. THEY FELT THAT BOTH THE DOMESTIC EXPANSIONARY
EFFECT OF THE CURRENT GERMAN EXPORT BOOM AS WELL AS
DEVELOPMENTS IN THE EC SNAKE MIGHT PUSH THE GERMAN
GOVERNMENT IN THIS DIRECTION. AS FAR AS THE SNAKE IS
CONCERNED THEY ARGUED THAT BY FALL GERMANY MIGHT HAVE TO
TAKE UP SIGNIFICANT AMOUNTS OF THE CURRENCIES OF OTHER
SNAKE COUNTRIES AND THAT EVEN APART FROM POSSIBLE
PRESSURE BY THE GOVERNMENTS OF THESE COUNTRIES, THE GERMAN
GOVERNMENT MIGHT DECIDE TO REVALUE IN ORDER TO AVOID THE
EXPANSIONARY EFFECT ON ITS DOMESTIC VOLUME OF MONEY OF
SUCH FOREIGN EXCHANGE INFLOWS. HILLENBRAND

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